# **Examination Warrant Number 10-PC-184-Z**

# Report of Examination of

Philadelphia Insurance Company Bala Cynwyd, PA

As of December 31, 2010

# Philadelphia Insurance Company

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Harrisburg, Pennsylvania November 23, 2011

Honorable Stephen J. Johnson, CPA Deputy Insurance Commissioner Commonwealth of Pennsylvania Insurance Department Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 10-PC-184-Z, dated, March 5, 2010, an examination was made of

# Philadelphia Insurance Company, NAIC Code: 23850,

a Pennsylvania-domiciled stock property and casualty insurance company, hereinafter referred to as "Company" or "PIC." The examination was conducted at the Company's home office, located at One Bala Plaza, Suite 100, Bala Cynwyd, PA 19004-1403.

A report of this examination is hereby respectfully submitted.

# **SCOPE OF EXAMINATION**

The Company was last examined as of December 31, 2005.

This examination covered the five-year period from January 1, 2006 through December 31, 2010, and consisted of a general survey of the Company's business practices, management, and operations, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department ("Department") and the National Association of Insurance Commissioners ("NAIC").

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a disclosure of other significant regulatory information.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of PricewaterhouseCoopers LLP ("PWC") provided an unqualified audit opinion on the Company's year-end financial statements based on statutory accounting principles.

During the examination, relevant work performed by the CPA firm during its annual audit of PIC was reviewed and incorporated into the examination workpapers.

The following company was examined at the same time during the above examination:

**Company** 

**NAIC Code** 

Philadelphia Indemnity Insurance Company ("PIIC")

18058

#### **HISTORY**

The Company was incorporated on July 15, 1986 as the Wheelways Insurance Company. It was licensed by the Department on August 22, 1986 and commenced business on October 23, 1986. The present name was adopted on November 30, 1990.

On December 1, 2008, Tokio Marine Holding, Inc. ("TMHD"), through its wholly-owned subsidiary, Tokio Marine & Nichido Fire Insurance Co., Ltd ("TMNF"), acquired indirect control of PIC and PIIC by becoming the sole owner of their parent company, Philadelphia Consolidated Holding Corp. ("PCHC"). The acquisition was made pursuant to the July 22, 2008 Merger Agreement among TMHD, Tokio Marine Investment (Pennsylvania) Inc. and PCHC. The Department granted approval for the acquisition of PCHC on October 3, 2008. TMHD is an insurance holding company organized under The Companies Act of Japan.

As of December 31, 2010, PIC was eligible to write excess and surplus lines business in forty-nine states, the U.S. Virgin Islands, and the District of Columbia. PIC is currently licensed in Pennsylvania and is authorized to transact those classes of insurance described in 40 P.S. § 382, Section 202, Subsection (b), Paragraph (1) Property and Allied Lines; (2) Inland Marine and Physical Damage and 40 P.S. § 382, Section 202, Subsection (c), Paragraph (1) Fidelity and Surety; (3) Glass; (4) Other Liability; (6) Burglary and Theft; (9) Elevator; (11) Auto Liability; (14) Workers' Compensation.

# MANAGEMENT AND CONTROL

#### CAPITALIZATION

As of the examination date, December 31, 2010, the Company's total capitalization was \$116,220,017, consisting of 299,996 capital shares of issued and outstanding common stock with a par value of \$14.25 per share amounting to \$4,274,943; \$2,114,547 aggregate write-ins for special surplus funds, \$18,642,853 in gross paid in and contributed surplus; and \$91,187,674 in unassigned funds (surplus).

The Company's minimum capital and surplus requirements for the types of business for which it is licensed, pursuant to 40 P. S. § 386.1, are \$1,850,000 and \$925,000, respectively. The Company has met all governing requirements throughout the examination period.

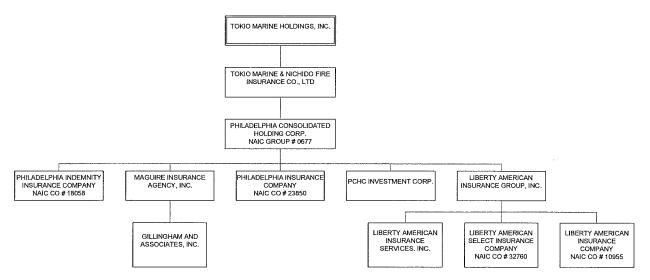
# **STOCKHOLDER**

All of the Company's common stock is held by its parent, PCHC. PCHC was a publicly-traded holding company on the NASDAQ stock exchange under the symbol "PHLY" before being acquired by TMHD and delisted from NASDAQ on December 1, 2008. No dividends were paid during the period under examination.

# **INSURANCE HOLDING COMPANY SYSTEM**

The Company meets the requirements for filing an insurance holding company system registration statement, in compliance with 40 P.S. §§ 991.1401-991.1413. Forms B and C were filed annually during the examination period.

TMHD is the ultimate controlling person in the system. The following diagram presents the members of the holding company system as of December 31, 2010:



For purposes of this examination report, the key members of the holding company system include the following entities, which are briefly described below:

# TOKIO MARINE HOLDINGS, INC.

TMHD is a publicly-held insurance holding company which was established on April 2, 2002 by TMNF. TMHD leads an international global insurance group with approximately 28,000 employees in 36 countries. TMHD is ranked in the Top 10 life/non-life insurance

company groups in the world based on its market capitalization. TMHD wholly-owns TMNF, which is Japan's oldest and largest property and casualty insurer in terms of revenue, and is the parent company of PCHC. TMHD common stock trades on the Tokyo and the Osaka stock exchanges. Its home office address is: Tokio Marine Nichido Building, 1-2-1 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan, and it is an insurance holding company under The Companies Act of Japan. No person is known to beneficially own 10% or more of its voting securities.

# **TOKIO MARINE & NICHIDO FIRE, CO., LTD**

TMNF is a Japan-domiciled Insurance company, established as the Tokio Marine Insurance Company on August 1, 1879, was formed by the merger between the Tokio Marine & Fire Insurance Company and the Nichido Fire and Marine Insurance Company on December 1, 2004. TMNF is the sole owner of all PCHC common stock.

# PHILADELPHIA CONSOLIDATED HOLDING CORP.

PCHC is the holding company for PIIC and PIC.

#### PHILADELPHIA INDEMNITY INSURANCE COMPANY

PIIC is a Pennsylvania-domiciled commercial property and casualty insurance company licensed as an admitted carrier in all 50 states and the District of Columbia.

# **MAGUIRE INSURANCE AGENCY, INC. ("MIA")**

MIA, founded in 1962, is the captive underwriting manager for PIIC and PIC and produces business primarily for them. MIA places select business with other markets under the Valley Forge Insurance Brokerage name.

# >GILLINGHAM AND ASSOCIATES, INC

Gillingham and Associates, Inc is an MGA that MIA purchased in 2008 to market and sell "outdoor" insurance products to guides and outfitters.

#### PCHC INVESTMENT CORP.

PCHC Investment Corp. is a Delaware-domiciled investment holding subsidiary.

# LIBERTY AMERICAN INSURANCE GROUP, INC ("LAIG")

LAIG is a Florida-domiciled holding company, which includes the following entities, all of whom have ceased writing new business (except National Flood business) and are allowing existing coverages to expire:

# **▶LIBERTY AMERICAN INSURANCE SERVICES, INC. ("LAIS")**

LAIS is a Florida-domiciled personal lines managing general agency, which produced insurance primarily for the homeowners and the manufactured housing markets in Florida.

# >LIBERTY AMERICAN SELECT INSURANCE COMPANY ("LASIC")

LASIC is a Florida-domiciled personal lines property and casualty insurance company for the homeowners and the manufactured housing markets and is licensed as an admitted carrier in eleven states.

# >LIBERTY AMERICAN INSURANCE COMPANY ("LAIC")

LAIC is a Florida-domiciled personal lines property and casualty insurance company for the homeowners and the manufactured housing markets and is licensed as an admitted carrier in Florida.

# >LIBERTY AMERICAN INSURANCE AGENCY ("LAIA")

LAIA was a subsidiary of LAIG, which operated as an independent retail agency and was disposed of in 2008.

# **BOARD OF DIRECTORS**

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2010:

Name and Address	Principal Occupation
James J. Maguire Wyndmoor, PA	Founder and Chairman Emeritus PIIC & PIC
James J. Maguire, Jr. Ft. Washington, PA	Chairman, Chief Executive Officer PIIC & PIC
Christopher J. Maguire Devon, PA	Co-President, Chief Operating Officer PIIC & PIC
Sean S. Sweeney Wayne, PA	Co-President, Chief Marketing Officer PIIC & PIC
Craig P. Keller Havertown, PA	EVP, Assistant Secretary, Treasurer, CFO PIIC & PIC
Michael J. Morris Wynnewood, PA	Retired Chief Executive Officer Transport International Pool Corporation
Donald A. Pizer Jenkintown, PA	Retired Partner Ernst & Young

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Michael J. Cascio Wyndmoor, PA

Consultant Kingsway Financial

Makoto Yoda Philadelphia, PA SVP & Corporate Liaison **PCHC** 

The Directors serve a one-year term and are elected at the annual stockholder's meeting.

PCHC has a Conflict of Interest Policy and a Code of Conduct in place that applies to all directors, officers and employees of PCHC and its subsidiaries. On an annual basis, each person subject to these policies must complete a questionnaire disclosing potential exceptions as defined in the policies.

#### COMMITTEES

The Company only has an audit committee at the Company level. All other committees are maintained at the Parent level, which is in accordance with PIC's By-laws. Directors and/or Officers were assigned to serve on the following Committees as listed below:

# **PCHC Board of Directors**

James J. Maguire

James J. Maguire, Jr.

Craig P. Keller

Christopher J. Maguire

Sean S. Sweeney

Tatsuhiko Hoshina

Fumiaki Namekawa

Shin-ichiro Okada

Hiroyuki Watabiki

**Kichiichiro**Yamamoto

Ian Brimecome

# **PCHC Audit Committee**

Fumiaki Namekawa (Chairperson)

James J. Maguire

Ian Brimecome

Craig P. Keller

**Kichiichiro**Yamamoto

# **PCHC Investment Committee**

Ian Brimecome (Chairperson)

James J. Maguire

James J. Maguire, Jr.

Craig P. Keller

Sean S. Sweeney

#### **PCHC Compensation Committee**

Ian Brimecome (Chairperson)

James J. Maguire

James J. Maguire, Jr.

Christopher J. Maguire

Shin-ichiro Okada

#### **PIC Audit Committee**

Donald A. Pizer (Chairperson)

Michael J. Cascio

Michael J. Morris

40 P.S.§ 991.1405(c)(3), Standards of management of an insurer within a holding company system, states: "not less than one-third of the directors of a domestic insurer and not less than one-third of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of such insurer or of any entity controlling, controlled by or under common control with such insurer and who are not beneficial owners of a controlling interest in the voting stock of such insurer of any such entity. At least one such person must be included in any quorum for the transaction of business of business at any meeting of the board of directors or any committee thereof."

Likewise, 40 P.S.§ 991.1405(c)(4) and (4.1), Standards of management of an insurer within a holding company system states: "The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have the responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating committees for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers."

40 P.S. § 991.1405(c)(5), Standards of management of an insurer within holding company system states: "The provisions of paragraphs (3), (4) and (4.1) shall not apply to a domestic insurer if the person controlling such insurer is an insurer or another business entity having a board of directors and committees thereof which already meet the requirements of paragraphs (3), (4) and (4.1).

The Company's Board and its Audit Committee comply with the aforementioned independence requirements of 40 P.S.§ 991.1405(c)(3), (4) and (4.1), since three members of the Board and all three members of the Audit Committee are neither officers, nor employees, nor beneficial owners of the insurer or of related entities. The Audit Committee performs all of the duties in 40 P.S.§ 991.1405(c)(4) and (4.1) described above; therefore, the Company complies with this section as it relates to duties performed by an independent committee or committees.

# **OFFICERS**

As of the examination date, December 31, 2010, the following officers were appointed and serving in accordance with PIC's By-laws:

Name	Title
James Joseph Maguire James Joseph Maguire, Jr. Christopher James Maguire Sean Stephen Sweeney Craig P. Keller William J. Benecke John W. Glomb Karen A. Gilmer-Pauciello	Founder and Chairman Emeritus Chairman, Chief Executive Officer Co-President, Chief Operating Officer Co-President, Chief Marketing Officer EVP, Assistant Secretary, Treasurer, CFO EVP SVP SVP

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Coleman V. Henry	SVP
Deborah A. Sutton	SVP
James F. Tygh	SVP

# CORPORATE RECORDS

#### **MINUTES**

A compliance review of corporate minutes revealed the following:

- The Annual Meetings of PIC's stockholder was held in compliance with its By-laws.
- The stockholder elected directors at such meetings in compliance with the By-laws.
- The stockholder ratified the prior year's actions of the officers and directors.
- Quorums were present at all directors' meetings.
- The Company's investment transactions are approved quarterly by the Board.
- All directors regularly attend Board meetings.
- The Board approves the reinsurance contracts.

# ARTICLES OF AGREEMENT

There were no changes or amendments to the Company's Articles during the examination period.

# **BY-LAWS**

There were no changes or amendments to the Company's By-Laws during the examination period.

#### SERVICE AND OPERATING AGREEMENTS

The Company is party to the following service and operating agreements which meet the fair and reasonable standards as contained in 40 P.S. §991.1405:

# **Management Agreement**

The captioned agreement is between the Company and its affiliate, MIA. It authorizes MIA to operate, conduct and otherwise manage the business of the Company, subject to the right and prerogative of the Company to overrule, revoke or countermand any basic insurance business decision contemplated by MIA, which the Company deems unwise or inimical to its best interest. The term "basic insurance business" shall include, but not be limited to: accepting or rejection of particular risks, premiums to be charged, and entering into reinsurance agreements subject to the Company's Board of Director approval. The aforementioned services include providing all staffing and facilities. In exchange for these services, the Company shall reimburse MIA for its expenses in providing these services. This reimbursement is in addition to the regular commission MIA is paid for business that may be produced directly by it or by any of its affiliates. Given the powers granted by this agreement, MIA is considered an "Underwriting Manager" for the Company. PIC remits annual expense reimbursements (\$4,462,653 in 2010) to MIA for these management services. The original agreement was effective for five years from May 20, 1991 and successively extended for additional periods through December 31, 2011.

# **Federal Income Tax Sharing Agreement**

The Company's federal income tax return is consolidated with the following entities:

# Common Parent Corporation

1. Philadelphia Consolidated Holding Corp.

# Subsidiaries of Common Parent

- 1. Maguire Insurance Agency, Inc.
- 2. PCHC Investment Corp.
- 3. Philadelphia Indemnity Insurance Company
- 4. Liberty American Insurance Group, Inc
- 5. Liberty American Insurance Services, Inc
- 6. Liberty American Select Insurance Company
- 7. Liberty American Insurance Company
- 8. Gillingham & Associates, Inc.

The method of allocation between the companies is subject to a written agreement which is approved by the Board. Allocations are based upon separate return calculations with current credit for net losses.

# REINSURANCE

# **POOLING AGREEMENT**

The Company and PIIC ("Group") have participated in a pooling agreement since October 1, 2004. Under this agreement, PIC cedes to PIIC 100% of its net insurance business produced, secured and written and PIIC then cedes to PIC 5% of all the combined net insurance business produced, secured and written by both companies. Each pool participant has a contractual right of direct recovery from its reinsurance treaties and its facultative reinsurers. Each pool participant also establishes its own provision for reinsurance and write-off of uncollectible reinsurance relating to its reinsurance treaties and facultative reinsurance.

The pooling participants and their percentage of participation in the pooled results are as follows:

Company	NAIC Code	Participation %
Philadelphia Indemnity Insurance Company	18058	95%
Philadelphia Insurance Company	23850	5%

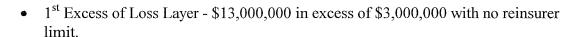
The combined net expenses of the two companies will be prorated between them in accordance with their participation in their combined net business. For the purposes of this Agreement, "net expenses" means both "loss expense incurred" and "other underwriting expenses incurred". Excluded from "net expenses" are all expenses allocated to investment operations, Federal Income Taxes, changes in ledger assets and ledger liabilities, gains or losses from changes in non-admitted assets, realized and unrealized capital gains and losses, and other surplus adjustments.

#### **CEDED**

The Company's reinsurance program is placed through intermediaries or directly with the reinsurer. Where intermediaries were used, the Company has the requisite contract in place with the intermediary with at least all of the statutory language required by 40 P.S. § 321.6. The Company has multiple active treaties in place on December 31, 2010, which are categorized as follows (treaties not considered material were not reflected in this examination report):

# **Casualty Excess of Loss**

The treaty is placed by Willis Re, Inc., a licensed reinsurance intermediary in Pennsylvania. It provides that casualty, liability, and fidelity risks in excess of \$3,000,000 are ceded up to a limit of \$21,000,000 in two layers as follows:



• 2<sup>nd</sup> Excess of Loss Layer - \$5,000,000 in excess of \$16,000,000 with a \$10,000,000 reinsurer limit, all loss occurrences.

The participants are: Allied World Reinsurance Company, Everest Reinsurance Company and Transatlantic Reinsurance Company. All reinsurers are at least "A" rated by A.M. Best, and participate at 15%, 30%, and 30%, respectively in each layer. The remaining 25% of each layer is not subscribed to by any reinsurer and therefore any liability subject to these treaties remains with the Company at this percentage.

# **Casualty Clash Excess of Loss**

The treaty is placed by Willis Re, Inc., a licensed reinsurance intermediary in Pennsylvania. Casualty and liability risks are protected from exposures such as extra-contractual obligations and judgments in excess of policy limits through three coverage layers as follows:

- 1<sup>st</sup> Excess of Loss Layer \$2,000,000 in excess of \$3,000,000 with a \$4,000,000 reinsurer limit, all loss occurrences and an annual terrorism limit of \$2,000,000.
- 2<sup>nd</sup> Excess of Loss Layer \$5,000,000 in excess of \$5,000,000 with a \$10,000,000 reinsurer limit, all loss occurrences and an annual terrorism limit of \$5,000,000.
- 3rd Excess of Loss Layer \$10,000,000 in excess of \$10,000,000 with a \$20,000,000 reinsurer limit, all loss occurrences and an annual terrorism limit of \$10,000,000.

There are eight external reinsurers who fully subscribe each layer at varying percentages. All the reinsurers are rated "A" by A.M. Best.

Also, an errors and omissions insurance policy provides an additional \$10,000,000 of coverage with respect to these exposures.

# **Property per Risk Excess**

The Company has four layers of coverage, which provide \$95,000,000 of loss coverage in excess of \$5,000,000, under three separate treaties. The first and third layers of the treaty are subscribed to by fifteen unaffiliated reinsurers through Willis Re, Inc.; the second treaty is directly written by General Reinsurance Corporation ("GenRe"), a Pennsylvania authorized reinsurer; and the third treaty, which covers the fourth layer, is subscribed to by two unaffiliated reinsurers. All the reinsurers except for one (which is rated as NR-4) are rated at least "A-" by A.M. Best or a similar rating agency. The layers are defined as follows:

• 1<sup>st</sup> Per Risk Excess Layer - \$5,000,000 in excess of \$5,000,000, which is 62.5% subscribed to by eight unaffiliated reinsurers at varying percentages. 37.5% of this

layer is not subscribed to by any reinsurer and therefore any liability subject to this treaty remains with the Company at this percentage. The loss limit on each loss occurrence in this layer is limited to \$10,000,000. However, this layer provides for four free reinstatements. The aggregate loss limit for all loss occurrences in this layer is \$25,000,000.

- 2<sup>nd</sup> Per Risk Excess Layer \$5,000,000 in excess of \$10,000,000, which is fully subscribed by GenRe. The loss limit on each loss occurrence in this layer is limited to \$10,000,000. However, this layer provides for three free reinstatements. The aggregate loss limit for all loss occurrences in this layer is \$20,000,000.
- 3<sup>rd</sup> Per Risk Excess Layer \$35,000,000 in excess of \$15,000,000, which is fully subscribed to by fourteen unaffiliated reinsurers at varying percentages. The loss limit on each loss occurrence in this layer is limited to \$35,000,000. However, this layer provides for one paid reinstatement. The aggregate loss limit for all loss occurrences in this layer is \$70,000,000.
- 4th Per Risk Excess Layer \$50,000,000 in excess of \$50,000,000, which is fully subscribed to by two unaffiliated reinsurers at 50% each (Arch Reinsurance Company and Tokio Marine Kiln (Lloyds) Syndicate 1880). The loss limit on each loss occurrence in this layer is limited to \$50,000,000. However, this layer provides for one paid reinstatement. The aggregate loss limit for all loss occurrences in this layer is \$100,000,000.

The property excess of loss reinsurance treaties discussed above provide for terrorism coverage in the aggregate of \$95,000,000 in excess of \$5,000,000 retention.

# **Catastrophe Excess of Loss**

Effective June 1, 2010, the property catastrophe program for open-market catastrophe reinsurance coverage is \$600,000,000 in excess of a \$100,000,000 per occurrence retention. The open-market catastrophe program has coverage provided by large reinsurers that are rated at least "A-" by A.M. Best Company (with the largest participant in each layer being Swiss Reinsurance America Corporation) and includes one mandatory reinstatement for each layer. The Company has four layers of coverage under the treaty, which is placed through Guy Carpenter & Company, LLC, a licensed reinsurance intermediary in Pennsylvania. The layers are defined as follows:

- 1<sup>st</sup> Excess of Loss Layer \$100,000,000 in excess of \$100,000,000, which is fully subscribed by various unaffiliated reinsurers.
- 2<sup>nd</sup> Excess of Loss Layer \$150,000,000 in excess of \$200,000,000, which is fully subscribed by various unaffiliated reinsurers.

- 3<sup>rd</sup> Excess of Loss Layer \$150,000,000 in excess of \$350,000,000, which is fully subscribed by various unaffiliated reinsurers.
- 4<sup>th</sup> Excess of Loss Layer \$200,000,000 in excess of \$500,000,000, which is fully subscribed by various unaffiliated reinsurers. This layer will only apply to losses occurring in the states of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont and the Canadian provinces of Newfoundland, New Brunswick, Nova Scotia, and Prince Edward Island.

#### **Facultative**

The Company has a Property Facultative Binding Authority Agreement in effect, which is written directly with GenRe. This agreement covers risks for property losses in excess of \$100,000,000 up to \$150,000,000, except for risks located in Florida, Hawaii or Harris County, Texas, where coverage for property losses is in excess of \$100,000,000 up to \$130,000,000. In addition, this agreement provides for terrorism coverage in the aggregate of \$50,000,000.

Facultative reinsurance that is provided on an individual risk basis is placed for property risks in excess of \$150,000,000, except for risks located in Florida, Hawaii or Harris County, Texas, where facultative reinsurance coverage is placed for property risks in excess of \$130,000,000.

The Company also has a Boiler and Machinery Facultative Agreement written directly with Travelers Indemnity Company, a Pennsylvania authorized reinsurer, which provides for 100% coverage up to a limit of \$25,000,000.

In addition to the aforementioned facultative treaties, the Company purchases individual facultative coverage when considered appropriate.

# **Quota Share**

The Company has three Quota Share reinsurance treaties with highly-rated unaffiliated companies, covering its Professional Liability ("ProfLiabQS"), Environmental Liability ("EnvLiabQS"), and First and Third Party Cyber Liability ("CyberQS") business. All ultimate assuming companies have a rating at least "A" by A. M. Best. A brief description of each follows:

- ProfLiabQS this treaty is directly placed with Cumis Insurance Society, Inc. and provides 50% Quota Share protection for this business.
- EnvLiabQS this treaty is placed by Willis Re Inc. and is 70% subscribed by six unaffiliated reinsurers with the remaining 30% being retained by the Company as

defined within the contract. The reinsurer limit of liability is \$15,000,000 under each policy, each loss occurrence.

 CyberQS - this treaty is placed by Guy Carpenter & Company, LLC and is subscribed to by Lloyds Syndicate - KILN 510 and provides 50% Quota Share protection for this business.

# **ASSUMED**

Besides the pooling agreement with the Company's affiliate, PIIC, the Company had no assumed reinsurance treaties in effect on December 31, 2010.

# TERRITORY AND PLAN OF OPERATION

The Company is licensed only in Pennsylvania and is an eligible surplus lines writer in forty-nine states, the District of Columbia, and the U.S. Virgin Islands. It focuses on underwriting the Group's niche products on a surplus line basis in those jurisdictions in which they are not offered on an admitted basis.

Through the inter-company reinsurance pooling agreement with PIIC, the Company assumes 5% of the two companies' combined specialty commercial property and casualty insurance products incorporating unique coverages and services for select target industries and niches. These products include commercial multi-peril package contracts for non-profit, religious, sports, educational, mental health and day-care organizations. It also participates in commercial auto insurance for the leasing and rental-car industries; property insurance for nursing homes and hospitals; inland marine coverage for builders' risk and miscellaneous property floaters; professional liability; and management liability products.

The Company's products are distributed through a diverse multi-channel delivery system centered on the Company's production underwriting organization. A select group of about 300 "preferred agents" and a broader network of approximately 14,000 independent producers supplement the production underwriting organization, which consisted of over 250 professional underwriters located in 46 regional and field offices across the United States as of December 31, 2010.

Direct									
	and Assumed	Ceded	Net Written	Percentage					
Line of Business	Premium	Premium	Premium	of Total					
Fire	\$ 437,093	\$ 402,481	\$ 34,612	0.0%					
Allied lines	355,016	306,904	48,112	0.0%					
Commercial multiple peril	78,981,206	25,985,741	52,995,465	53.8%					
Inland marine	761,965	196,686	565,279	0.6%					
Medical malpractice - claims-made	85,732	0	85,732	0.1%					
Other liability - occurrence	20,323,550	10,225,650	10,097,900	10.3%					
Other liability - claims-made	17,677,624	2,913,256	14,764,368	15.0%					
Products liability - occurrence	67,036	10,105	56,931	0.1%					
Private passenger auto liability	195,811	0	195,811	0.2%					
Commercial auto liability	14,880,321	862,342	14,017,979	14.2%					
Auto physical damage	5,401,971	151,625	5,250,346	5.3%					
Fidelity	308,992	6,926	302,066	0.3%					
Burglary and theft	55,699	2,142	53,557	0.1%					
Totals	\$ 139,532,016	\$ 41,063,858	\$ 98,468,158	100.0%					

Since the prior examination, the Company has experienced significant growth, showing a \$45 million, or 86%, increase in premium writings on a net basis. The growth in the commercial auto liability line accounts for 27% of this increase, at \$12,487,201, or 816% growth, since the prior examination; commercial multi-peril accounts for 25%, at \$11,564,655 (28% growth). Other liability-occurrence contributed 21%, at \$9,457,348 (1,475% growth); other liability-claims-made accounts for 16%, at \$7,113,438, (93% growth); and auto physical damage for 11%, at \$5,243,518 (insignificant writings during the last exam). Medical malpractice is a new line and contributed 0.2% of the increase. The lines of business showing decreases are: Inland Marine, down 68%, and workers' compensation, which is no longer written.

# SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are on an earned/incurred basis, and encompass the five-year period covered by this examination.

		Percentage	
Premiums earned	_\$	390,128,083	100.0 %
Losses incurred	\$	168,657,906	43.2 %
Loss expenses incurred		35,933,424	9.2 %
Other underwriting expenses incurred		122,363,998	31.4 %
Net underwriting gain or (loss)		63,172,755	16.2 %
Totals	\$	390,128,083	100.0 %

The PIC reported the following net underwriting, investment and other gains or losses during the period under examination:

	2010	2009		2008		2007			2006
Admitted assets	\$ 293,969,250	\$	269,899,710	\$	240,460,992	\$	201,028,080	\$	164,830,752
Liabilities	\$ 177,749,233	\$	165,846,228	\$	156,368,573	\$	122,031,727	\$	101,185,097
Surplus as regards policyholders	\$ 116,220,017	\$	104,053,482	\$	84,092,419	\$	78,996,353	\$	63,645,655
Gross premium written	\$ 139,532,016	\$	154,083,515	\$	140,673,362	\$	116,184,225	\$	89,072,092
Net premium written	\$ 98,468,158	\$	93,898,219	\$	84,448,749	\$	73,371,501	\$	63,095,244
Underwriting gain/(loss)	\$ 9,347,019	\$	12,260,674	\$	7,943,412	\$	16,685,513	\$	16,936,137
Investment gain/(loss)	\$ 9,432,728	\$	7,501,391	\$	2,914,790	\$	7,400,931	\$	5,142,561
Net income	\$ 12,536,134	\$	13,588,297	\$	6,238,271	\$	15,520,558	\$	16,102,218

#### **ACCOUNTS AND RECORDS**

The Company uses a variety of systems to process its business and to report its financial results. All records are kept and maintained at the Company's home office in Bala Cynwyd, PA and at offsite data centers. The following is a summary of each:

PIC uses the purchased/modified "AQS" Premium Processing and Policy Management System and the internally-developed "APPS" Claims Management and Billing/Receivables System. AQS was internally customized after purchase. Various electronic spreadsheet applications are used to combine and coordinate financial information from various sources and to package it for internal and external reporting purposes. Information is transferred between these various systems via automated interfaces.

Reinsurance Accounting is performed via a purchased application "ProCede" and an internally developed "xCede" application.

The "Flexi" system was purchased to support all the Company's general ledger, accounting, and reporting functions.

Investment accounting functions are outsourced to General Re New England Asset Management, Inc. ("GR-NEAM"), which uses the "CAMRA" system. GR-NEAM also acts as the company investment advisor.

#### PENDING LITIGATION

The company is subject to routine legal proceedings in the course of its business. The examination team obtained and reviewed a listing of the 2010 fees and work summaries of attorneys used by PIC and PCHC. Specific inquiries were also sent to four selected attorneys included on these lists, as well as to PIC's in-house attorney, with detail responses being received from all inquiries. These lists and responses described no litigation that indicates a potentially material adverse effect on the Company's financial condition or results of operations. We have therefore concluded that no such material adverse effect is known to exist.

# FINANCIAL STATEMENTS

The financial condition of the Company as of December 31, 2010, and the results of its operations for the five-year period under examination, are reflected in the following statements:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;

Comparative Statement of Income;

Comparative Statement of Capital and Surplus; and

Comparative Statement of Cash Flow.

# Comparative Statement of Assets, Liabilities, Surplus and Other Funds As of December 31,

Bonds Common stocks Cash, cash equivalents, and short term investments Other invested assets Receivable for securities	\$ 2010 247,999,324 351,500 15,391,983 0 466,605	\$ 2009 218,996,220 370,100 15,263,987 0	\$	2008 174,423,952 16,018,365 19,771,268 0 343,337	\$	2007 141,684,397 16,886,409 16,271,240 397,074 67,437	\$ 2006 120,747,128 13,680,190 10,551,657 535,262 93,381
Subtotals, cash and invested assets Investment income due and accrued Premiums and agents' balances due Amounts recoverable from reinsurers Other amounts receivable under reinsurance contracts Current federal and foreign income tax recoverable and interest thereon Net deferred tax asset Receivable from parent, subsidiaries and affiliates Aggregate write-ins for other than invested assets	 264,209,412 2,768,991 10,263,939 5,817,752 0 268,283 7,109,116 3,531,757 0	 234,630,307 2,336,679 14,088,127 6,928,052 88,473 0 6,166,550 4,720,444 941,079		210,556,922 2,027,462 14,296,460 8,298,937 990,345 279,218 4,011,651 0		175,306,557 1,446,547 19,331,494 1,590,976 0 0 3,351,925 582 0	 145,607,618 1,176,765 14,769,205 402,552 0 0 2,874,612 0
Total	\$ 293,969,250	\$ 269,899,711	_\$_	240,460,995	_\$_	201,028,081	 164,830,752
Losses Reinsurance payable on paid loss and loss adjustment expenses Loss adjustment expenses Commissions payable, contingent commissions and other similar charges Other expenses Taxes, licenses and fees Current federal and foreign income taxes Unearned premiums Ceded reinsurance premiums payable (net of ceding commissions) Provision for reinsurance Payable to parent, subsidiaries and affiliates Payable for securities	\$ 83,700,134 12,076,089 22,416,337 6,104,649 46,220 27,128 0 50,059,474 3,297,432 19,166 2,604 0	\$ 70,178,569 9,561,113 19,265,367 3,915,101 82,664 (11,254) 1,649,026 47,771,402 10,773,389 0 702,602 1,958,250	\$	59,120,160 8,701,340 16,145,186 8,047,295 949,623 (11,254) 0 43,644,410 5,246,417 0 14,374,643 150,756	\$	49,447,335 6,449,319 13,204,768 0 753,352 60,167 910,246 38,171,177 12,905,599 0 0	\$ 41,700,608 4,249,601 12,536,342 0 548,033 138,579 1,076,911 32,987,851 7,761,992 0 0 185,180
Total liabilities Aggregate write-ins for special surplus funds Common capital stock Gross paid in and contributed surplus Unassigned funds (surplus) Surplus as regards policyholders Totals	\$ 177,749,233 2,114,547 4,274,943 18,642,853 91,187,674 116,220,017 293,969,250	\$ 165,846,229 1,640,664 4,274,943 18,642,853 79,495,022 104,053,482 269,899,711	\$	156,368,576 0 4,275,000 18,642,796 61,174,623 84,092,419 240,460,995	\$	122,031,728 0 4,275,000 15,132,845 59,588,508 78,996,353 201,028,081	\$ 101,185,097 0 4,275,000 15,132,845 44,237,810 63,645,655 164,830,752

# **Comparative Statement of Income For the Year Ended December 31,**

Underwriting Income	2010	2009	2008	2007	2006
Premiums earned	\$ 96,180,086	\$ 89,771,227	\$ 78,975,518	\$ 68,188,173	\$ 57,013,079
Deductions:					
Losses incurred	47,601,273	41,398,393	35,440,814	25,948,804	18,268,622
Loss expenses incurred	10,101,759	9,074,703	7,957,905	4,518,972	4,280,085
Other underwriting expenses incurred	29,130,035	27,037,457	27,633,387	21,034,884	17,528,235
Total underwriting deductions	86,833,067	77,510,553	71,032,106	51,502,660	40,076,942
Net underwriting gain or (loss)	9,347,019	12,260,674	7,943,412	16,685,513	16,936,137
Investment Income					
Net investment income earned	9,086,624	8,203,026	7,518,406	6,663,080	5,303,643
Net realized capital gains or (losses)	346,104	(701,635)	(4,603,616)	737,851	(161,082)
Net investment gain or (loss)	9,432,728	7,501,391	2,914,790	7,400,931	5,142,561
Other Income					
Net income before dividends to policyholders and					
before federal and foreign income taxes	18,779,747	19,762,064	10,858,202	24,086,446	22,078,698
Federal and foreign income taxes incurred	6,243,613	6,173,767	4,619,931	8,565,888	5,976,480
Net income	· \$ 12,536,134	\$ 13,588,297	\$ 6,238,271	\$ 15,520,558	\$ 16,102,218

# Comparative Statement of Capital and Surplus For the Year Ended December 31,

	2010	2009	2008	2007	2006
Surplus as regards policyholders,					
December 31, previous year	\$ 104,053,482	\$ 84,092,419	\$ 78,996,353	\$ 63,645,655	\$ 45,629,173
Net income	12,536,134	13,588,297	6,238,271	15,520,558	16,102,218
Net unrealized capital gains or (losses)	0	2,729,525	(3,440,413)	(421,159)	831,499
Change in net deferred income tax	1,442,639	1,037,989	1,938,276	1,261,013	844,600
Change in nonadmitted assets	(1,793,072)	2,605,252	(3,150,019)	(1,009,714)	140,165
Change in provision for reinsurance	(19,166)	0	0	0	98,000
Capital changes:					
Paid in	0	0	0	0	2,400,000
Transferred to surplus	0	(57)	0	0	0
Surplus adjustments:					
Paid in	0	0	3,509,951	0	(2,400,000)
Transferred from capital	0	57	0	0	0
Change in surplus as regards policyholder for the year	12,166,535	19,961,063	5,096,066	15,350,698	18,016,482
Surplus as regards policyholders,					
December 31, current year	\$ 116,220,017	\$ 104,053,482	\$ 84,092,419	\$ 78,996,353	\$ 63,645,655

# Comparative Statement of Cash Flow For the Year Ended December 31,

		2010		2009	2008	2007	2006
Cash from Operations							
Premiums collected net of reinsurance Net investment income Miscellaneous income	\$	94,894,053 10,095,577 1	\$	100,181,193 8,851,621 372,548	\$ 81,187,867 7,528,208 (372,549)	\$ 73,953,583 6,635,688 (2)	\$ 64,950,928 5,423,535 (2)
Total income Benefit and loss related payments		104,989,631 30,454,432		109,405,362 28,109,325	88,343,526 30,223,929	80,589,269 17,190,782	70,374,461 10,833,951
Commissions, expenses paid and aggregate write-ins for deductions Federal and foreign income taxes paid (recovered)		33,889,339 8,160,922		37,991,131 4,245,523	24,478,730 5,308,585	24,758,523 9,206,832	19,367,090 8,256,992
Total deductions		72,504,693		70,345,979	 60,011,244	 51,156,137	 38,458,033
Net cash from operations		32,484,938		39,059,383	28,332,282	29,433,132	 31,916,428
Cash from Investments							
Proceeds from investments sold, matured or repaid: Bonds Stocks Other invested assets Net gain or (loss) on cash and short-term investments Miscellaneous proceeds		33,398,254 18,600 0 57 28,874		38,410,850 20,160,389 0 (166) 2,150,832	 33,948,487 3,579,723 17,189 0 4,423,894	 37,886,316 10,721,281 0 0 293,575	 15,966,893 3,133,250 0 (653) 260,964
Total investment proceeds		33,445,785		60,721,905	 41,969,293	 48,901,172	 19,360,454
Cost of investments acquired (long-term only): Bonds Stocks Miscellaneous applications Total investments acquired		63,496,577 0 2,453,729 65,950,306		83,245,024 1,710,233 0 84,955,257	 68,598,794 11,409,126 4,678,803 84,686,723	 59,028,131 13,262,962 323,046 72,614,139	 43,751,092 9,607,741 165,875 53,524,708
Net cash from investments		(32,504,521)		(24,233,352)	(42,717,430)	(23,712,967)	(34,164,254)
Cash from Financing and Miscellaneous Services Other cash provided (applied):							
Capital and paid in surplus, less treasury stock Other cash provided or (applied)	,	0 147,579		0 (19,333,312)	 3,509,951 14,375,225	 0 (582)	 0 787,465
Net cash from financing and miscellaneous sources	,	147,579	_	(19,333,312)	 17,885,176	 (582)	 787,465
Reconciliation of cash and short-term investments:							
Net change in cash and short-term investments Cash and short-term investments:		127,996		(4,507,281)	3,500,028	5,719,583	(1,460,361)
Beginning of the year		15,263,987	_	19,771,268	 16,271,240	 10,551,657	 12,012,018
End of the year	\$	15,391,983	- \$	15,263,987	\$ 19,771,268	\$ 16,271,240	\$ 10,551,657

# **SUMMARY OF EXAMINATION CHANGES**

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

# **NOTES TO FINANCIAL STATEMENTS**

#### **ASSETS**

# **INVESTMENTS**

As of December 31, 2010, PIC's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 247,999,324	93.9 %
Common stocks	351,500	0.1 %
Cash	(839,462)	(0.3)%
Cash equivalents	3,999,711	1.5 %
Short-term investments	12,231,734	4.6 %
Securities lending reinvested collateral assets	 466,605	0.2 %
Totals	\$ 264,209,412	100.0 %

PIC's bond and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation 1 - highest quality 2 - high quality 6 - in or near default Totals	\$ Amount 262,293,466 1,734,803 202,500 264,230,769	Percentage 99.2 % 0.7 % 0.1 % 100.0 %
Years to Maturity	Amount	Percentage
1 year or less	\$ 47,659,204	18.1 %
2 to 5 years	84,034,780	31.8 %
6 to 10 years	100,241,538	37.9 %
11 to 20 years	21,642,976	8.2 %
over 20 years	 10,652,271	4.0 %
Totals	\$ 264,230,769	100.0 %

As shown above, the majority of the invested assets are in high quality bonds. Bond investments are comprised of: \$15.6 million, or 6.3%, in non-mortgage-backed securities issued by the U.S. Treasury and U.S. government sponsored agencies; \$169.3 million, or 68.2%, in municipal bonds issued by states and their political subdivisions; \$47.2 million, or 19.1%, in

mortgage-backed securities issued or guaranteed by U.S. government sponsored agencies; \$16.0 million, or 6.4%, in debt issued by unaffiliated commercial enterprises, \$258,000, or 0.1%, of which is in commercial mortgage-backed securities. As noted above, 18% of the portfolio matures in one year or less and 88% matures in 10 years or less, with all but \$1 million, or 0.4%, publicly traded. As of December 31, 2010, no single issue exceeded 3% of the Company's invested assets.

The Company divested itself of substantially all common stocks in 2009 and the entire remaining balance represents the Federal Home Loan Bank ("FHLB") of Pittsburgh stock which is held by the Company in compliance with its obligation as a member of the FHLB. Common stocks now represent just 0.1% of the total invested assets as compared to 6.5% as of the last examination.

The Company has a written investment policy as required by 40 P.S. § 653b (b). The investment policy is reviewed and approved on an annual basis by the Board. The Company followed its investment policy throughout the period under examination.

PIC utilizes external independent professional investment managers for its portfolio, with all investment transactions being initiated by GR-NEAM with guidance on the type and amount of investments it is able to purchase based upon the Company's investment policy. As of December 31, 2010, these investments consist of a diversified portfolio of issues and issuers, and on a statement value basis, approximately 93.9% are bonds.

The Company has custodial agreements in effect with The Bank of New York and The Federal Home Loan Bank, which comply with the requirements of 31 Pa. Code § 148(a).

# **LIABILITIES**

#### LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company's Loss and Loss Adjustment Expenses Reserves as of December 31, 2010 were developed by the Company's actuarial department under the direction of Senior Vice President and Chief Actuarial Officer, James F. Tygh, FCAS, MAAA, the Company's appointed actuary. Mr. Tygh provided the opinion that the reserve amounts "make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements."

In order for the examination team to gain an adequate comfort level with the Company's loss and loss adjustment expense reserve estimates, the Department's internal property and casualty actuarial examiners performed a risk-focused review of the Company's loss and loss adjustment expense reserves in conjunction with this examination. In the course of their work, the Department's internal property casualty actuarial examiners relied upon underlying financial and risk-focused procedures performed by the Department's financial examiners, the Company's

Internal Audit Department, PWC, as well as by PWC's actuarial staff. As a result of this review, the actuarial staff obtained sufficient evidence to support that the Company's loss and loss adjustment expense reserve estimates at December 31, 2010 appear reasonable.

The Department accepts the Company's appointed actuary's conclusion, as of December 31, 2010, that the Company's reserves "make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements."

# **SUBSEQUENT EVENTS**

# MOST RECENT FINANCIAL STATEMENT HIGHLIGHTS

The Company reflected the following in its December 31, 2011 financial statements: total assets equaled \$331,998,935; total liabilities equaled \$206,288,334; surplus equaled \$125,710,601; and the Company produced net income of \$10,067,177. None of these figures were verified as part of this examination and they are included for information purposes only.

#### FORMATION OF A NEW HOLDING COMPANY

On June 29, 2011, TMHD established a new U.S. holding company to serve as the parent of all the Tokio Marine Group's North American holdings. The new holding company is named Tokio Marine North America ("TMNA"). TMNA also formed a new subsidiary, TMNA Services, LLC, to provide professional support services for the TMNA subsidiaries. Japanese and U.S. regulatory approvals were obtained.

On March 31, 2012, ownership of 100% of PCHC common stock was contributed by TMHD to the North American holding company TMNA. PCHC is now a wholly owned subsidiary of TMNA.

#### OFFICER CHANGE

In September 2011, Christopher J. Maguire resigned from his position as Co-President and COO, effective January 2, 2012.

#### RECOMMENDATIONS

#### PRIOR EXAMINATION

The prior examination report contained the following recommendations:

1. It is recommended that Code of Conduct Certifications be prepared by all subject employees of the Company, as dictated by the Company's Code of Conduct policy, each year and that said certifications be readily available for review for future examinations.

The Company complied with this recommendation.

2. It is recommended that the Company keep complete and accurate records of all official proceedings of its board of directors and committees in compliance with Pennsylvania Business Corporation Law 15 Pa. C.S. § 1508(a).

The Company complied with this recommendation.

3. It is recommended that the Company revise the Management Agreement and the Federal Income Tax Sharing Agreement to include provisions for penalties and interest in case of late payments in order to comply with 40 P.S. § 991.1405.

The Company complied with this recommendation.

#### **CURRENT EXAMINATION**

No recommendations are being made as a result of the current examination.

#### CONCLUSION

As a result of this examination, the financial condition of Philadelphia Insurance Company, as of December 31, 2010, was determined to be as follows:

	Amount		Percentage	
Admitted assets		293,969,250	100.0 %	
Liabilities	\$	177,749,233	60.5 %	
Surplus as regards policyholders		116,220,017	39.5 %	
Total liabilities and surplus	\$	293,969,250	100.0 %	

Since the previous examination, made as of December 31, 2005, PIC's assets increased by \$161,733,510; its liabilities increased by \$91,142,666; and its surplus increased by \$70,590,844.

This examination was conducted by Melissa Greiner, Lucy H. Mikula, Stephanie E. Norris, CPA, CFE, Keith D. Wandel, Jr., CFE, Dennis D. Williams, and John J. Gaynard, CPA, CFE, with the latter in charge.

Respectfully,

Annette B. Szady, C

Director, Bureau of Financial Examinations

Joseph G. Jacobs, CFE

**Examination Manager** 

John J. Gaynard, CPA, CFE

Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies.